No. 7128

In the United States Circuit Court of Appeals for the Ninth Circuit

ERLE P. HALLIBURTON, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

VIDA C. HALLIBURTON, PETITIONER

v.

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ON PETITION FOR REVIEW OF DECISION OF THE UNITED STATES BOARD OF TAX APPEALS

PETITION FOR REHEARING

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Assistant Attorney General.

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PETITION FOR REHEARING

To the Honorable Circuit Court of Appeals for the Ninth Circuit and the Judges thereof:

Comes now the respondent in the above-entitled cause and respectfully represents to this Honorable

Court that an opinion was filed the 3rd day of June 1935, in accordance with which judgment was entered reversing the order of the United States Board of Tax Appeals, subject to right of consideration of the question whether the stock received by the petitioners and the oil companies severally was substantially in proportion to their respective interests in the property prior to the exchange. He presents this petition for rehearing, and, in support thereof, respectfully represents and shows to this Honorable Court the following:

I

That this Honorable Court erred in holding that the purchase of stock for cash is a transaction falling within the provisions of Section 203 (b) (4) of the Revenue Act of 1924.

II

That the Court erred in overruling the long adhered to construction placed upon the statute by the Treasury Department.

III

That the Court erred in holding that a gain or loss can be realized on the purchase of corporate stock, depending upon the then or subsequent market value of the stock so purchased.

ARGUMENT

I

The purchase of stock for cash is not a transaction falling within the provisions of section 203 (b) (4)

The Commissioner assessed a tax upon the profit realized by the petitioners on the exchange of assets for 178/350 of the stock in a newly organized corporation. Petitioners contended, and the Court held, that the exchange was nontaxable because, at the time of the exchange, several oil companies purchased for cash the remaining outstanding stock of the corporation.

Section 203, Revenue Act of 1924, provides that, upon the sale or exchange of property, the entire amount of the gain or loss shall be recognized, except in certain definitely specific transactions. The presumption of the realization of a gain or loss is thus established, except in the few classes of sales or exchanges described in the statute. It would be an aid to construction to determine which of the excepted transactions are sales and which are exchanges.

The statute does not define either a sale or an exchange. Recourse must be had to the ordinarily accepted meaning of the terms. They are often used interchangeably, but the fundamental distinction between a sale and an exchange is that, in the former, property is transferred in consideration of an agreed price expressed in terms of money, while,

in an exchange, property is transferred in return for other property, without the intervention of money, 23 *Corpus Juris* 185. The distinction appears to promote the intendment of the taxing act. The purpose of the enactment is stated in House Report No. 179, 68th Congress, 1st Session, p. 16, as follows:

> These provisions are based upon the theory that the types of exchanges specified in section 203 are merely changes in form and not in substance, and consequently should not be considered as affecting a realization of income at the time of the exchange. In other words, these provisions result not in an exemption from tax but in a postponement of tax until the gain is realized by a pure sale or by such an exchange as amounts to a pure sale. It follows, therefore, that in the case of such an exchange the property received should be considered as taking the place of the property exchanged. * * *

The transaction in which the Halliburton Company sold its stock for cash does not fall within Section 203 (b) (4). Manifestly, the transactions falling within the types of exchanges specified in Section 203 must be transactions such as produce income. Congress was not providing for the postponement of a tax on a nonexistent gain. Where the transaction cannot result in the production of income, it would be erroneous to group it with the transactions that do. A purchase of stock for cash

never results in income to the purchaser. *Eaton* v. *White,* 70 F. (2d) 449 (C. C. A. 1st). A purchaser of an original issue of stock at less than market has made an advantageous bargain, but he derives no taxable income from the transaction. Income will be realized only when he sells such stock for an amount in excess of cost. *Rose* v. *Trust Co.,* 28 F. (2d) 767 (C. C. A. 5th); *Durkee* v. *Welch,* 49 F. (2d) 339 (S. D. Calif.). Likewise, the receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither a taxable gain nor a taxable loss to the corporation, irrespective of whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.[1] *Carter*

[1] Article 543, Regulations 65 (promulgated under the 1924 Act), provides:

ART. 543. *Sale of capital stock.*—The proceeds from the original sale by a corporation of its shares of capital stock, whether such proceeds are in excess of or less than the par value of the stock issued, constitute the capital of the company. If the stock is sold at a premium, the premium is not income. Likewise, if the stock is sold at a discount, the amount of the discount is not a loss deductible from gross income. If, for the purpose of enabling a corporation to secure working capital or for any other purpose, the shareholders donate or return to the corporation to be resold by it certain shares of stock of the company previously issued to them, or if the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A corporation realizes no gain or loss from the purchase or sale of its own stock. See article 563.

Hotel Co. v *Commissioner,* 67 F. (2d) 642 (C. C. A. 4th). Consequently, neither the several oil companies nor the Halliburton Company could have realized a gain when the latter acquired cash for its stock. Being *per se* a transaction in which no gain could possibly arise, it must necessarily be excluded from Section 203 (b) (4), which plainly contemplates transactions in which a gain can be realized. The exclusion of the purchase of the stock by the several oil companies for cash deprives the petitioners of the benefit of Section 203 (b) (4), since, after the exchange of their property for stock, they were not in control of the corporation.

An examination of the statute discloses that a sale of any kind of property for cash is not among the exceptions to the general rule that, upon the sale of property, the gain or loss shall be immediately recognized. The intervention of cash, as the only consideration in a sale, immediately results in the realization of a gain or loss, and nothing in the statute discloses a legislative intent to postpone the tax on the gain in such a case. In fact, the general rule clearly discloses a contrary intent.

As to exchanges of property for other property, without the intervention of money, it was early recognized that, in some cases, the property received should be considered as taking the place of the property exchanged, without the immediate recognition of any realized gain or loss. But in no case was cash treated as "property" in an exempt

exchange. The 1918 Act provided that, when property is exchanged for other property, the property received in exchange, shall, for the purpose of determining the gain or loss, be treated as the equivalent of cash to the amount of its fair market value, if any. Section 202 (b). Plainly, cash was not contemplated as property, since to say that cash, the property received, shall be treated as the equivalent of cash to the amount of its fair market value would be meaningless. The 1918 Act was found to be productive of much uncertainty and litigation, and was replaced by Section 202 (c) of the Revenue Act of 1921, which provided that, in an exchange of property for property, no gain or loss shall be recognized, unless the property received in exchange had a definite and readily realizable market value. Again it would be to no purpose to legislate that no gain or loss shall be recognized unless cash, the property received in exchange, had a readily realizable market value. The phrase "readily realizable market value" applied to cash means nothing. The 1921 Act was also found to be too indefinite to be applied with accuracy and consistency, and revisions were suggested when the Revenue Act of 1924 was under consideration. In House Report No. 179, *supra,* it is stated (p. 13):

> It appears best to provide generally that gain or loss is recognized from all exchanges and then except specifically and in definite terms those cases of exchange in which it is not desired to tax the gain or

> allow the loss. This results in definiteness and accuracy and enables a taxpayer to determine prior to the consummation of a given transaction the tax liability that will result therefrom.

The new proposals were embodied in Section 203 of the statute involved in the present controversy. Nowhere does the Act provide that cash is property, when exchanged for other property, for purposes of non-taxable exchanges. In all the acts, exchanges of property are treated as closed and completed transactions, presumptively resulting in the realization of gains or losses, except in certain specific cases. The intervention of money in a transfer of property needs no presumption of immediate taxability of a realized gain. It is a pure sale. No other transaction could fix more definitely the realization of either a gain or a loss.[2]

The same conclusion is reached by another line of reasoning. If petitioners had transferred their stock to the Halliburton Company in exchange for all the stock of that company, clearly the exchange would have been nontaxable. *B. F. Shaw Printing Co.* v. *Commissioner,* 72 F. (2d) 187 (App. D. C.); *American Compress & Warehouse Co.* v. *Bender,* 70 F. (2d) 655 (C. C. A. 5th). If the

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[2] Compare Section 202 (c), Revenue Act of 1924, c. 234, 43 Stat. 253, which provides:

SEC. 202. (c) The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. (U. S. C., Title 26, Section 933.)

several oil companies had purchased for cash all of the stock of the Halliburton Company, the transaction would also have been nontaxable, not, however, because it was a nontaxable exchange, but because the purchaser of stock realizes no gain or loss by the transaction. In the instant case, the taxpayers exchanged their assets for only 178/350 of the authorized capital stock, and seek to avoid the tax upon the gain realized because someone else purchased for cash 13/30 of the stock in the same company as an investment.[3]

It is submitted that the statute would have applied only had the oil companies transferred property upon which a profit could have been realized. The property transferred was money. They could not have realized a gain or a loss by selling money, or by exchanging money for other money or other property. Nontaxable exchanges are limited to exchanges which presumptively give rise to a gain or loss. Cf. *Pinellas Ice Co.* v. *Commissioner,* 287 U. S. 462.

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[3] Example 3, Article 112 (b) (5), Regulations 86 (promulgated under the Revenue Act of 1934) is directly in point:

Example 3: B owns certain real estate which cost him $50,000 in 1920, but which has a fair market value of $200,000 in 1934. He transfers the property to the N Corporation in 1934 for 78 percent of all classes of stock of the corporation, the remaining 22 percent of the stock of the corporation having been issued by the corporation in 1933 to other persons for cash. B realizes a taxable gain of $150,000 on this transaction. (See section 112 (h).)

Furthermore, when property acquired in an exchange described in Subdivision 203 (b) (4) is sold, the basis is the same as in the case of the property exchanged. Section 204 (a) (6). In the instant case, the new company received cash from the oil companies in exchange for its stock. Section 204 (a) (6) supplies the basis which must be used in case the property acquired, cash in this case, is sold. But cash is not bought and sold. It must be presumed that Congress did not legislate for transactions that never happen.

It is submitted that money is not property within the contemplation of Section 203 (b) (4).

II

The construction of the statute consistently adhered to by the Treasury Department should not be overruled, except for weighty reasons

Early in 1928, the Treasury Department construed the word "property", as used in Section 203 (b) (4), to mean property other than money. In G. C. M. 2062, VII–1 Cumulative Bulletin 161, 163, it was said:

> Under section 203 (a) gain or loss is recognized in every sale or exchange, unless within one of the exceptions enumerated in the other subdivisions of the section. The taxpayers contend that they come within the exception contained in section 203 (b) (4) and that the cash paid for stock by the six companies is property within the meaning of the exception. It is the opinion of this office that the word "property" as used in

> section 203 (b) (4) means property other than money. This subdivision refers to an "exchange" in four instances. The word "purchase" is not used. The payment of cash for stock is a purchase, not an exchange. The language must be construed according to its commonly accepted meaning. This position is supported by the manner in which the word "exchange" is used throughout the Act, and also by the manner in which references are made to "property" as distinguished from "money" in the provisions with reference to exchanges, particularly in section 203 (d), (e), and (f). To sustain the taxpayer's contention would necessitate placing a strained construction upon the language used.

This ruling was published in the cumulative bulletin containing the rulings made during the period January to June 1928. The ruling has been consistently adhered to since then, and has not been modified or reversed by any court prior to the decision in this case.

Beginning with the case of *Edwards* v. *Darby,* 12 Wheat. 206, the Supreme Court established its rule that great weight would be given to the construction given to a statute by department officials who are called upon by law to act under the statute and to carry it into effect. See *National Lead Co.* v. *United States,* 252 U. S. 140; *Logan* v. *Davis,* 233 U. S. 613.

In *Universal Battery Co.* v. *United States,* 281 U. S. 580, the Court upheld the construction of a

tax statute urged by the Government largely because it had been construed by the Bureau, and said (p. 583):

> This construction of those terms has been adhered to in the Internal Revenue Bureau for about ten years and it ought not to be disturbed now unless it be plainly wrong. We think it is not so, but is an admissible construction.

Section 203 (b) (4) was reenacted as Section 112 (b) (5) in the Revenue Acts of 1928, 1932, and 1934 without any change whatever, after the Treasury Department had announced its construction that the word "property", as used in Section 203 (b) (4) of the Revenue Acts of 1924 and 1926, means property other than money, thereby indicating an adoption by Congress of this interpretation. Where, in addition to contemporaneous administrative construction, there is also reenactment by Congress, the Supreme Court has laid down even a stronger rule than that based merely upon administrative construction. By reenactment, Congress makes that construction a part of the statute. In *United States* v. *Hermanos y Compania,* 209 U. S. 337, the principles are stated thus (p. 339):

> We have said that when the meaning of a statute is doubtful great weight should be given to the construction placed upon it by the department charged with its execution. * * * And we have decided that the reenactment by Congress, without change, of

> a statute, which had previously received long continued executive construction, is an adoption by Congress of such construction. * * *

The case of *Mass. Mutual Life Ins. Co.* v .*United States,* 288 U. S. 269, is a strong case on the effect of reenactment of provisions in a revenue act without alteration. The Court said (p. 273):

> The Congress in the Revenue Acts of 1928 and 1932 reenacted § 245 without alteration. This action was taken with knowledge of the construction placed upon the section by the official charged with its administration. If the legislative body had considered the Treasury interpretation erroneous it would have amended the section. Its failure so to do requires the conclusion that the regulation was not inconsistent with the intent of the statute (*National Lead Co.* v. *United States,* 252 U. S. 140, 146; *Poe* v. *Seaborn,* 282 U. S. 101, 116; *McCaughn* v. *Hershey Chocolate Co.,* 283 U. S. 488, 492; *Costanzo* v. *Tillinghast,* 287 U. S. 341) unless, perhaps, the language of the act is unambiguous and the regulation clearly inconsistent with it. Compare *Louisville & N. R. Co.* v. *United States,* 282 U. S. 740, 757–8.

To the same effect are *McCaughn* v. *Hershey Chocolate Co.,* 283 U. S. 488, 492; *Spring City Co.* v. *Commissioner,* 292 U. S. 182, 189; *Helvering* v. *Bliss,* 293 U. S. 144; *Zellerbach Paper Co.* v. *Helvering,* 293 U. S. 172.

It is submitted that the principles referred to require the approval of the construction contended for by respondent.

III

The Court erred in holding that a gain or loss can be realized on the purchase of corporate stock, depending upon the then or subsequent market value of the stock so purchased

The Court sanctions the taxation of unrealized profits, thereby doing great violence to the principles underlying our system of taxation. The several oil companies realized no profit by the purchase of the Halliburton stock, nor could they, in the absence of a sale of the purchased stock, subsequently realize a profit, even though there was an increase in the market value of the stock. No taxable gain is realized by the mere purchase of stock. *Eaton* v. *White, supra; Omaha Nat. Bank* v. *Commissioner,* 75 F. (2d) 434 (C. C. A. 8th). Appreciation or enhancement in value of property is not taxable until realized by a sale or other disposition. *Rose* v. *Trust Co., supra.* The Supreme Court has so held repeatedly. In *Weiss* v. *Wiener,* 279 U. S. 333, the Court said (p. 335):

> They [the income tax laws] do not charge for appreciation of property or allow a loss from a fall in market value unless realized in money by a sale.

In *Eisner* v. *Macomber,* 252 U. S. 189, it was said (pp. 214–215):

> Secondly, and more important for present purposes, enrichment through increase in value of capital investment is not income in any proper meaning of the term.

In *Lucas* v. *American Code Co.,* 280 U. S. 445, the Court said (p. 449):

> Generally speaking, the income-tax law is concerned only with realized losses, as with realized gains.

It is submitted that the oil companies could realize no gain by the purchase of the Halliburton stock. Consequently, the transaction must be excluded from Section 203 (b) (4) and the taxpayers here are deprived of the benefit thereof.

Wherefore, upon the foregoing grounds, respondent respectfully requests that this, his petition for rehearing, be granted by this Honorable Court, and that, upon further consideration by this Court, the decision of the Board of Tax Appeals, as originally entered, be affirmed, since it is in accordance with law and supported by the pertinent statutes, Treasury Department regulations, and judicial authorities.

Respectfully submitted.

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Assistant Attorney General.
SEWALL KEY,
JOHN G. REMEY,
Special Assistants to the Attorney General.

JUNE 1935.

CERTIFICATE OF COUNSEL

The Commissioner of Internal Revenue, respondent herein, by his attorneys, hereby certifies that the foregoing petition for rehearing is not presented for the purpose of delay or vexation, but is, in the opinion of counsel, well founded in law and proper to be filed herein.

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